

STATE OF MICHIGAN
BEFORE THE MICHIGAN PUBLIC SERVICE COMMISSION

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In the matter of the application of)	
Upper Peninsula Power Company)	Case No. U-16568
for authority to reconcile its revenue)	
decoupling mechanism for the 2010)	
calendar year)	
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NOTICE OF PROPOSAL FOR DECISION

The attached Proposal for Decision is being issued and served on all parties of record in the above matter on March 28, 2012.

Exceptions, if any, must be filed with the Michigan Public Service Commission, P.O. Box 30221, 6545 Mercantile Way, Lansing, Michigan 48909, and served on all other parties of record on or before April 18, 2012, or within such further period as may be authorized for filing exceptions. If exceptions are filed, replies thereto may be filed on or before May 2, 2012. **The Commission has selected this case for participation in its Paperless Electronic Filings Program. No paper documents will be required to be filed in this case.**

At the expiration of the period for filing exceptions, an Order of the Commission will be issued in conformity with the attached Proposal for Decision and will become effective unless exceptions are filed seasonably or unless the Proposal for Decision is reviewed by action of the Commission. To be seasonably filed, exceptions must reach the Commission on or before the date they are due.

MICHIGAN ADMINISTRATIVE HEARING
SYSTEM
For the Michigan Public Service Commission

Peter L. Plummer
Administrative Law Judge

March 28, 2012
Lansing, Michigan

STATE OF MICHIGAN
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FOR THE MICHIGAN PUBLIC SERVICE COMMISSION

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PROPOSAL FOR DECISION

I.

PROCEDURAL HISTORY

On May 13, 2011, the Upper Peninsula Power Company (UPPCO) filed an Application with the Michigan Public Service Commission (Commission) seeking approval of its revenue decoupling mechanism (RDM) reconciliation for 2010, and authority to implement a surcharge to recover a revenue shortfall. The Commission authorized UPPCO's RDM in Order entered on December 16, 2009 in Case No. U-15988.¹

During a pre-hearing conference on June 30, 2011, UPPCO and Commission Staff appeared, and a petition to intervene filed by Calumet Electronics Corporation was granted.

Consistent with the schedule adopted during the pre-hearing conference, the hearing was conducted on December 21, 2011. On that date UPPCO entered the testimony of David J. Kyto, Director, Rate Case Process in the Regulatory Affairs Department of Integrys Energy Group, Inc., and Exhibits A-1, A-2, A-3, A-4 and A-5. Staff entered the testimony of Katie J.

Smith, an Economic Analyst in the Energy Efficiency Section of the Electric Reliability Division, and Nicholas M. Revere, an Economic Analyst in the Rates and Tariff Section of the Regulated Energy Division, along with Exhibits S-1, Revised S-2, Revised S-3, Revised S-4, S-5 and S-6. Under the schedule established during the pre-hearing conference, UPPCO and Staff filed post-hearing Briefs and Reply Briefs.

II.

REVENUE DECOUPLING MECHANISM

On December 11, 2009, the parties in Case No. U-15988 filed a Settlement Agreement that on p 5 states:

- 10) By this settlement agreement, UPPCO, Staff, Calumet, Stone and MTU agree as follows:

* * *

- h. Consistent with the Commission's approval granted in Case No. U-15645 establishing a pilot decoupling mechanism, it is agreed that an identical mechanism should be approved for UPPCO effective January 1, 2010.

Subsequently, the Commission approved the Settlement Agreement, including the cited provision authorizing the RDM, in an Order entered on December 16, 2009.

The case referenced in the Settlement Agreement and December 16, 2009 Order is *In the matter of Consumers Energy Company*, Case No. U-15645.² In that case, the Commission described the purpose and function of an RDM as:

¹ The Commission authorized UPPCO's RDM in a December 16, 2009 Order *In the matter of the application of Upper Peninsula Power Company for authority to increase retail electric rates*, Case No. U-15988. That case was consolidated with Case No. U-15989, which dealt with depreciation rates.

A decoupling mechanism is typically created as a solution to further the public policy objectives of assisting customers to use energy more efficiently and reduce the utility's reliance on certain existing fuel sources, while reducing overall costs. The principal purpose of decoupling is to transform the current regulatory paradigm that gives a utility a strong incentive to sell as much electricity as possible, without regard to the negative effects upon overall costs and individual customer bills. Decoupling can be utilized to manage changes in electricity sales attributable to updated building codes, expanded energy efficiency programs (including federal and state weatherization programs), upgrades in appliance efficiency, and other similar demand side policies. Decoupling is a ratemaking mechanism that removes the link between energy sales, or throughput, and the utility's non-fuel revenues. With decoupling, differences between projected and actual sales, and the associated differences in the utility's revenues, are reconciled periodically. A well-crafted decoupling mechanism will likely mean that changes in revenue resulting from changes in consumption will no longer cause a utility to file a general rate case. Rather, a utility's need to file a general rate case will be driven by changes in the utility's underlying costs. *In the matter of Consumers Energy Company*, Case No. U-15645, November 2, 2009 Order, pp 51-52.

Based on the Commission's Order in this case, the RDM is authorized provided

UPPCO satisfies the following Contingencies:

1. meeting certain reporting requirements;
 2. exceeding the benchmarks for the energy optimization program established pursuant to Public Act 295 of 2008;
 3. committing to provide enhanced energy efficiency programs and demand side resources that enable all customers classes to effectively manage rising energy costs, including proposals to accomplish this in the next filed rate case; and
 4. surpassing minimum reliability standards under rule and law.
- December 16, 2009 Order, p 5.

The Commission held the RDM "shall be based upon the...mechanism illustrated in Exhibit E to the settlement agreement." *Id.* The Commission also provided the following specifics for the RDM:

² The first reconciliation of Consumers' RDM, Case No. U-16566, is pending before the Commission. See <http://efile.mpsc.state.mi.us/efile/viewcase.php?casenum=16566> (visited March 26, 2012).

The pilot decoupling mechanism shall be symmetrical and shall reconcile non-fuel/non-purchase power revenue for all rate schedules except for NatureWise. In UPPCo's annual decoupling mechanism reconciliation proceeding, which shall be filed on or before April 1 of each year, UPPCo's actual (non-weather adjusted) sales per customer during the 12-month period from January 1 to December 31 will be compared with the base sales per customer level amount established in this case for all rate schedules except for NatureWise. Any sales per customer variance will be multiplied by the non-fuel revenue per kWh in order to obtain the non-fuel revenue variance per customer. Then, the non-fuel revenue variance per customer shall be multiplied by the average monthly number of customers established in this rate case in order to obtain the resulting non-fuel revenue variance. Any overage or shortfall shall be credited or surcharged on a per kWh basis going forward. A deadband is not included in the pilot mechanism. The application of the mechanism upon specific customer groups, customer classes, or a combination thereof, will be determined in the reconciliation proceeding. *Id.*, pp 5-6.

In regards to reconciliation of the decoupled revenue, which are to be filed annually by April 1, the Commission directed:

In future proceedings, the parties agree that UPPCo will file comments or proposals to address the regulatory lag involved in annual reconciliations, exclusions of revenues (sales) attributable to service outages or other similar circumstances, risk of assessment for both the utility and customers, and recommendations for adjustments and evaluation of pilot programs. Other parties may also file comments and proposals on these issues. *Id.*, p 7.

The Commission left to the reconciliation proceeding, which is to be conducted as a contested case, the determination of "how the mechanism will apply customer groups, customer classes, or a combination thereof." *Id.*, p 6. To make that determination UPPCO was directed to "file data on its average customer sales level." *Id.*

A. UPPCO's Energy's Application

Consistent with the Commission's directive in Case No- U-15988, UPPCO filed the Application at issue in this case.³ In that filing, UPPCO's actual (non-weather adjusted) sales per customer for the period between January 1, 2010 and December 31, 2010 (reconciliation period) were compared to base sales per customer figures established in Case No. U-15988. Mr. Kyto characterized this as an "average use per customer" methodology, which he asserts is in accord with Exhibit E of the Settlement Agreement approved by the Commission in Case No. U-15988. 2 TR 28-29, 37.

UPPCO's proposed RDM calculations excludes sales for NatureWise, which is consistent with the Commission's directive in the December 16, 2009 Order. In addition, UPPCO removed sales associated Real Time Market Pricing (RTMP) because they are PSCR revenues that were credited against power supply costs in its 2010 PSCR reconciliation (Case No. U-16031-R). 2 TR 35-36. UPPCO asserts the exclusion of the RTMP revenue is consistent with the December 16, 2009 Order's provision limiting decoupling to non-fuel/non-purchase power revenue. In the Application, UPPCO calculated a gross non-fuel revenue variance of \$2,737,546 under-collection. 2 TR 29. However, when the Application was filed, UPPCO anticipated recovering \$900,000 in net proceeds from a former large industrial primary customer that was proceeding through bankruptcy at that time. 2 TR 30-31. When the anticipated recovery was deducted from the initial non-fuel revenue variance, UPPCO determined it experienced a \$1,837,546 non-fuel revenue shortfall. Exhibit A-1.

While this case was pending, UPPCO submitted an updated RDM that indicates a non-fuel revenue variance of \$1,723,294. 2 TR 34; Exhibit A-3. The updated RDM reflects the net amount UPPCO actually received in its former customer's bankruptcy proceeding, \$1,014,252. 2 TR 35. Mr. Kyto testified that amount is proposed to be applied to the under-recovery amount attributable to its primary customers. Id. In addition to its primary customer grouping, UPPCO proposes another group consisting of residential customers, and a third group of secondary customers.⁴ Exhibit A-3. Applying the average use per customer calculation to UPPCO's proposed customer grouping results in a RDM surcharge of: 0.223¢/kWh for residential; 0.347¢/kWh for secondary; 0.258¢/kWh for primary; and a company-wide average surcharge of 0.277¢/kWh. Id. The per kWh surcharge would be applied on a service rendered basis from December 1, 2011 through December 1, 2012. 2 TR 29; Exhibit A-2.

Mr. Kyto testified that UPPCO has satisfied the four (4) Contingencies set forth in the Commission's approval of the RDM. Case No. U-15988, December 16, 2009 Order, p 5. Specifically, it provided actual sales data as requested, and surpassed minimum reliability standards required under rule and law. 2 TR 27-28. Further, by using an Independent Energy Optimization Program Administrator, the other two contingencies pertaining to energy optimization and efficiency have been satisfied. Settlement Agreement, p 5, fn 2. Ms. Smith agrees that the Contingencies have been satisfied. 2 TR 114.

³ The Commission's Order in Case No. U-15988 directed UPPCO to file its RDM reconciliation on or before April 1 of each year. In an Order entered on March 24, 2011 in this case, the filing date for the 2010 reconciliation was extended to May 13, 2011.

⁴ During the RDM reconciliation period, no revenues were received, or charges allocated, to another customer class identified in Exhibit E to the Settlement Agreement: secondary and primary Retail Open Access. Exhibit A-3.

B. Staff's Proposal

Rather than the average use per customer methodology proposed by UPPCO, Staff proposes an actual exposure methodology be utilized, to which Mr. Revere testified:

This method compares the Company's total actual sales per rate schedule with the total forecasted sales per rate schedule used to calculate the rates approved in MPSC Case No. U-15988. The resulting difference in sales per rate schedule is multiplied by each schedule's non-fuel rate to give the net recovery amount per schedule. This method gives the Company's actual exposure to changes in revenue due to the sales changes between the rate case and what was actually experienced by the Company.
2 TR 82; See also Exhibit S-5.

Staff advances the actual exposure method, which essentially decouples revenue based on total revenue gains and shortfalls by rate schedules, which it notes control the allocation of UPPCO's costs under its Cost of Service Studies. More importantly, grouping customers by the rate schedule avoids the arbitrary customer grouping Mr. Revere testified could result under the grouping proposed by UPPCO under the average use per customer methodology. 2 TR 83. On this point, Mr. Revere testified:

[T]he large difference in average use between the rate schedules the Company's groups consist of makes it inappropriate to combine the rates schedules in the same manner as the Company. For example, the actual usage per customer for schedule A-1 is around 5,512 (Revised Exhibit S-3, line 11, column a), while the actual usage per customer for schedule AH-1 is almost double that (Revised Exhibit S-3, line 11, column b). As the number of customers on A-1 is ten times the number on schedule AH-1, the average usage per customer for the combined group would skew towards that for A-1, while not reflecting reality for either schedule. Both schedules are included in the Residential class in the Company's calculation. The effect for Secondary and Primary schedules is even greater. For example, the actual average usage for P-1 customers is more than ten times greater than that for C-1 customers. At the same time, there were ten times as many customers on the C-1 schedule. Again, the results from combining these two schedules reflects reality for neither. In fact, in extreme cases, the change in average usage for a combined group could move in a direction opposite that of its constituent schedules.

2 TR 77-78; Exhibit S-3.

Under Staff's actual exposure methodology and rate schedule grouping, the total non-fuel revenue variance is \$223,118. Exhibit S-5.

In addition to the actual exposure methodology, Staff proposes the elimination of three rate schedules.⁵ The first is the per-lamp lighting rate, which UPPCO also agrees should be excluded. 2 TR 78. The next is Schedule SL-3, which would ensure consistency by removing all lighting customers, not just that under the per-lamp lighting rate. 2 TR 79, 81. The third is Schedule A, which included just the one customer that went bankrupt during the reconciliation period. Mr. Revere testified that the loss of sales attributable to that customer is due to it going bankrupt, and thus beyond the Commission's intent in authorizing the RDM: recover sales lost only as a result of energy efficiency methods. 2 TR 79-80. Accordingly, Staff "excluded all Schedule A related bankruptcy proceeding recoveries..." from its RDM calculations. Id., 80. Mr. Revere also testified Schedule A should be excluded because of the fact the entity is no longer a customer, any recovery attributed to it would necessarily have to come from other customers in the primary group, a result Mr. Revere termed "unreasonable." Id. Eliminating Schedule A, but maintaining UPPCO's proposed methodology and customer grouping, reduces the net recovery amount to \$1,383,133.⁶ Exhibit S-1.

Mr. Revere agrees that UPPCO's average use per customer methodology is identical to that referenced in ¶10h of the Settlement Agreement and the December 16, 2009 Order. 2 TR 93. In the event the Commission decides to employ the

⁵ Staff agrees that sales associated with RTMP should, as UPPCO proposes, be removed from the RDM calculations. See Staff's Initial Brief, pp 11-12.

average use per customer methodology, Mr. Revere recommends it be applied to customers by rate schedule, with the exclusion of Schedule A and Schedule SL-3, in order to “yield reasonable results.” 2 TR 82. Under that methodology and customer grouping, the variance is \$186,126. 2 TR 81-82; Exhibit S-4.

III.

RECOMMENDED RDM

The essence of the dispute in this case goes to the question of whether the Commission established a specific methodology for the RDM in Case No. U-15988, or was some degree of flexibility provided that would allow for modification through this proceeding. As noted, the parties agreed and the Commission held, the RDM “shall be based upon the revenue decoupling mechanism illustrated in Exhibit E.” Settlement Agreement, p 5; December 16, 2009, Order, p 5. UPPCO, which devised its proposed RDM to be consistent with Exhibit E, argues this provision precludes consideration of any other mechanism in this proceeding. Staff argues the Commission authorized a flexible and open-ended RDM that can be modified if the facts warrant.

One component of Staff’s argument is that the RDM is intended to only recover revenue lost due to energy efficiency. 2 TR 79-80. Given this, any revenue lost to other factors, such as the bankruptcy of the Schedule A customer, cannot be recovered through the RDM. In support, Staff points to the Commission’s Order authorizing Consumers Energy’s RDM, Case No. U-15645, which was expressly adopted in the

⁶ Eliminating all three rate schedules, but maintaining UPPCO’s proposed methodology and customer grouping, only results in a \$9,938 reduction in the net variance amount. Exhibit S-2.

December 16, 2009 Order in Case No. U-15988, authorizing UPPCO's RDM. In the Consumers Energy case, the Company proposed a dead-band based sales adjustment and a revised decoupling mechanism applicable to all residential, secondary, and primary customers. Case No. U-15645, November 2, 2009 Order, pgs. 47-48. Staff did not object to the dead-band mechanism, but offered as an alternative "an energy optimization (EO) lost revenue tracker." *Id.*, p 47. Subsequently, both the parties sought approval of the revised decoupling mechanism, although Staff maintained its preference for the EO lost revenue tracker. *Id.*, p 50. Ultimately, the Commission agreed "in concept with both Consumers and Staff" and found it "timely to put a decoupling mechanism in place...." *Id.*, pp 51-52. In authorizing the RDM, the Commission did not express or, as Mr. Revere testified, imply the mechanism was limited to revenue associated with energy optimization. In fact, had it so intended, the Commission would have adopted Staff's EO lost revenue tracker. Finally, the November 2 Order served to terminate Consumers Energy's electric choice incentive mechanism, which protected the Company and its customers "from a significant variation in ROA [Retail Open Access] sales levels as compared to those estimated in base sales rates." Case No. U-15645, November 2, 2009 Order, p 57, [bracketed comment added]. That step was taken, *inter alia*, based on "[t]he effect of the tracker mechanism adopted in this order...." *Id.*, p 58. Accordingly, the RDM in Case No U-15645, and by extension in this case, is intended to mitigate the loss of non-fuel revenues, irrespective of whether they are attributable to energy efficiencies.

The next determination is whether the RDM is rigid, i.e. limited to the methodology in Exhibit E to Settlement Agreement, or flexible, the methodology can be modified if warranted by the record in this case. As noted, UPPCO relies on the language in the U-16568

Settlement Agreement. However, that provision cannot be read in a vacuum. The Settlement Agreement/December 16, 2009 Order created a basis upon which the RDM was to be carried out, i.e. Exhibit E, but also left other considerations for a future case, including “[t]he application of the mechanism upon specific customer groups, customer classes, or a combination thereof....” December 16, 2009 Order, p 6. To make that determination, the Application in this case was to include testimony and exhibits concerning these issues, along with “comments or proposals to address the regulatory lag involved in annual reconciliations, exclusions of revenues (sales) attributable to service outages or other similar circumstances, risk of assessment for both the utility and customers, and recommendations for adjustments and evaluation of pilot programs.” Id., p 7. Other parties were also invited to “file comments and proposals on these issues.” Id. Finally, a ruling in Case No. U-15645 also indicates the RDM is subject to modification:

While the November 2 order appears to be clear that the decoupling mechanism is a pilot program, and that the Commission intends to review several aspects of the program after the first year of real world experience, the Commission hereby clarifies that order to explain that, concomitant with the initial reconciliation, the Commission intends to approve operation of the decoupling mechanism for the initial year, with continuation being subject to review as described in the [November 2 Order, p 54].
Case No. U-15645, January 25, 2010 Order, p 4.

In considering the Settlement Agreement/December 16, 2009 Order in Case No. U-15988, along with the RDM authorized in U-15645, this is the proper proceeding for the Commission to review, evaluate, and if warranted, modify the RDM.

Having determined some degree of flexibility is available in the RDM and revenue it covers is not limited to those associated with energy efficiency, the inquiry turns to the key issue in this case: what RDM is appropriate under the Commission’s Order and this record.

As discussed, UPPCO proposes an average use per customer RDM, which is identical to the one contained in Exhibit E to the Settlement Agreement of Case No. U-15988, and proposes a customer class based on the rate classes used in that case. When factoring in the net amount received in the bankruptcy involving a former large industrial customer, UPPCO contends it experienced a \$1,723,294 revenue shortfall during 2010. UPPCO proposes to recover that shortfall by allocation to three customer classes: residential, primary, and secondary. Based on this record, UPPCO's proposed RDM, including its customer grouping by class, fully comports with the Commission's authorization of a mechanism that determines a total revenue variance for the specified time period, including the components expressly provided for in the December 16, 2009 Order. There is no contention that the figures or calculations used in UPPCO's proposed RDM are inaccurate.

As noted, the December 16, 2009 Order contemplated some flexibility in crafting the RDM once "real world" data was available. However, Staff's actual exposure methodology goes beyond this concept by seeking to limit the RDM to solely recovering revenues gained or lost due to energy efficiency. Along the same lines, Staff's proposed RDM seeks to exclude Schedule A because the lost sales were not the result of energy efficiency, but rather the bankruptcy of the single customer in that rate class. However, no such limitation can be reasonably inferred from the December 16, 2009 Order, which authorizes an RDM that is "a ratemaking mechanism that removes the link between energy sales, or throughput, and the utility's non-fuel revenues." *In the matter of Consumers Energy Company*, Case No. U-15645, November 2, 2009 Order, p 51. Further, the sales forecast used to set rates in Case No. U-15988, and thus the rates approved in that case, included

Schedule A. The sales forecast is an integral component of the mechanism and should not

be altered through this process. Along the same lines, the Commission expressly held the RDM “shall reconcile non-fuel/non-purchase power revenue for all rate schedules...,” which precludes the exclusion of Schedule A and Schedule SL-3. Case No. U-15988, December 16, 2009 Order, p 5.⁷ Having said that, the exclusion of the RTMP revenue from the RDM calculation is warranted because, similar to the NatureWise revenue, it is not non-fuel/non-purchase power revenue.

Based on the foregoing, Staff’s proposed actual exposure methodology is inconsistent with the purpose and intent of the RDM authorized in the December 16, 2009 Order. Conversely, the average use per customer methodology proposed by UPPCO is consistent with that Order.

IV.

CONCLUSION

Based on the foregoing, UPPCO has complied with the four (4) contingencies identified by the Commission as a predicate to the authorization of an RDM. The Commission’s authorization of a RDM did not preclude, if warranted, application of a methodology other than average use by customer. Consistent with the flexibility in the RDM, the actual exposure methodology proposed by Staff is a proper consideration in this case. However, the Commission’s authorization of RDM was not limited to recovery of revenues associated with energy optimization. Therefore, Staff’s proposed methodology

⁷ Mr. Kyto makes a valid point that excluding revenues lost because a large customer went bankrupt during the reconciliation period would, for the sake of consistency, also require exclusion of revenues from a large customer coming on-line. 2 TR 41. Either result would violate the Commission’s directive that the RDM be symmetrical, which Mr. Revere testified means, in the context of decoupling, credits or surcharges resulting from sales increases or decreases. 2 TR 90-91.

and customer groupings, which is limited to revenues associated with energy efficiency, is inconsistent with the Commission's authorization of an RDM for UPPCO. The average use per customer methodology proposed by UPPCO utilizes the specific factors the Commission identified in its authorization of the RDM, and results in a \$1,723,294 revenue shortfall during 2010. There is no substantive evidence on this record that other factors should be included in the methodology.

UPPCO experienced a \$1,723,294 revenue shortfall between January 1, 2010 and December 31, 2010, that it is authorized to recover under an RDM. Exhibit A-3. That shortfall should be collected through surcharges to UPPCO's customer classes as set forth in Exhibit A-5.

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